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C O N F I D E N T I A L SECTION 01 OF 03 MOSCOW 000403

SIPDIS

DEPT FOR EUR/RUS, FOR EEB/ESC/IEC GALLOGLY AND WRIGHT
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E.O. 12958: DECL: 02/17/2019

TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)

SUBJECT: CEO MILLER TELLS AMBASSADOR GAZPROM HAS NO FINANCIAL CONSTRAINTS; ACCUSES UKRAINE OF "THEFT" WHILE DENYING ANY REPUTATIONAL DAMAGE TO

REF: A. MOSCOW 367

[1](#)B. MOSCOW 153

Classified By: DCM Eric S. Rubin for Reasons 1.4 (b/d)

SUMMARY

[1](#)1. (C) In a February 13 meeting with the Ambassador, Gazprom CEO Alexey Miller acknowledged the difficult economic environment but said his company thought the downturn would last no more than six months and had no intention of altering its long-term plans, including the building of the Nord Stream and South Stream pipelines (ref A). Miller vehemently defended Gazprom and Russia's actions in the gas dispute with Ukraine (ref B), denying any reputational damage as a gas supplier and accusing Ukraine of theft, which he called an old "game" in Ukraine. The transit of Russian gas to Europe through Ukraine will likely remain a problem for years to come but the answer is not Gazprom's uneconomic multi-billion dollar efforts to bypass Ukraine, but rather a transparent business based on commercial realities and rooted in a contractual relationship. End summary.

WHAT FINANCIAL CRISIS?

[1](#)2. (C) The Ambassador met with Gazprom CEO Miller February 13, the first high-level meeting between the company and the USG in over two years. The Ambassador opened the meeting by describing USG plans to "reset" the relationship with the advent of a new U.S. Administration. He said we hoped the reset would include a renewed dialogue on energy issues, both in government and business channels. That dialogue would take place against the backdrop of the global economic downturn and the concomitant sharp drop in demand for energy, including natural gas.

[1](#)3. (C) Miller responded that that he personally hoped for better ties and saw this meeting as a step in that direction. He said he also hoped the U.S. and Russia could establish a constructive energy dialogue. Miller acknowledged the impact of the financial crisis on Gazprom. Demand for gas was falling and with it prices. Miller blamed the crisis on "systemic" factors and said it indicated a need to "re-work the Bretton Woods global financial architecture."

[1](#)4. (C) However, Miller said Gazprom's assessment was that the crisis would last little more than six months and that energy demand would begin to rise again by the end of 2009 (a view that is remarkably consistent with official GOR policy). Demand for gas had been strong and rising for eight years; should his company react, Miller asked rhetorically, to a temporary downturn. With that in mind, Miller said the crisis would have little impact on Gazprom's long-term strategy, which he described as diversifying export routes, diversifying markets, and diversifying its production portfolio, including internationally. The company planned to proceed on schedule with all of its strategic investments, including especially Nord Stream and South Stream (ref A).

[1](#)5. (C) Moreover, Miller claimed that Gazprom was facing no financing constraints. He predicted the company would not have any trouble raising money given its "investment grade" bond rating. In fact, he maintained that the crisis had lowered the cost of many of the company's inputs, such as pipes and labor, and that Gazprom's expansion plans were therefore even more affordable. In that regard, he noted that Gazprom is even moving ahead with the purchase (reportedly for \$5 billion) of the 20% of Gazpromneft shares owned by ENI.

[1](#)6. (C) Miller acknowledged that should the downturn last longer than expected, Gazprom might have to "review conditions" and adjust its plans in the future. However, he claimed to have "already sold gas for 2013 delivery" in Europe and insisted that the pipelines must be built on schedule to allow Gazprom to deliver that gas.

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HIGHER DOMESTIC PRICES LOCKED IN

[1](#)7. (C) The Ambassador asked Miller if scheduled price increases for currently low-priced domestic gas could move forward given the political difficulty of raising such prices at a time of economic recession. Miller responded that the question was not whether to raise domestic prices but how quickly given the crisis. He said that by 2011 the domestic prices Gazprom will charge are to be at net-back parity with European prices (European price minus transport and tax). Moreover, he maintained that what the government does with

respect to natural gas prices will not affect Gazprom, which has already signed "thousands of contracts" with consumers for gas deliveries in 2011 and beyond at the higher scheduled prices.

UKRAINIAN GAS "THEFT"

18. (C) Miller became extremely animated when responding to the Ambassador's inquiries related to the gas dispute with Ukraine. The Ambassador noted press reports quoting EU Energy Commissioner Piebalgs to the effect that the EU had seen no evidence of Ukrainian theft of Russian gas intended for Europe during the first week of January, the proximate cause given by Russian officials for the cutoff.

19. (C) Miller responded forcefully and colorfully that no one could doubt that the Ukrainians had been stealing Russian gas. Often raising his voice and at times literally rising from his seat, Miller described the Ukrainian political leadership as a "criminal enterprise," and Ukraine's actions during the crisis as "totally illogical." "I'd like to meet the person who claims Ukraine didn't steal gas." He then launched into assertions that gas theft by Ukraine is a vast business, a "game," that has been going on for decades. Claims of theft aside, Miller mentioned, without elaboration, that EU monitors were no longer needed in Ukraine.

110. (C) In discussing the crisis, Miller noted his disbelief that his Ukrainian counterpart, NaftoHaz head Oleg Dubyna, needed to check with Ukrainian President Viktor Yushchenko before signing a deal. (Comment: Miller seemed to have forgotten that he, too, only signed a contract after Prime Minister Putin gave the green light following his meeting with Tymoshenko. End comment.) Miller said that when he pressed Dubyna to sign a contract that had been agreed to on both sides, Dubyna told him that if he did not check with Yushchenko first, the Ukrainian president would "crush" him.

111. (C) Miller added that he welcomed the move to market pricing and long-term contracts with Ukraine that was embodied in the agreement (ref B), but said contracts would not eliminate the risk Ukraine poses to Gazprom's ability to sell gas to its customers in the rest of Europe. Miller said that Ukrainian "theft" of Russian gas, "even during Soviet times," meant the risk would always be there.

112. (C) In response to the Ambassador's query about what would happen in the event of Ukraine failing to adhere to the agreement and falling into arrears, Miller stressed that Ukraine must pay its gas bills on time. He said the contract with Ukraine leaves no room for arrears. If Ukraine falls behind in payments even one month, it would then have to pre-pay to receive any more gas. If it is unable to pay, Miller said, Gazprom would not supply any more gas. Miller claimed that Gazprom "knew" that Ukraine had the ability to pay its debts in December, prior to the gas cutoff, but that it had chosen not to do so. He said he did not know what Ukraine would do if it didn't have the money to pay in the future. He noted, however, that the economic crisis has resulted in much lower Ukrainian gas consumption, which could perhaps make it easier for Ukraine to pay its bill.

REPUTATIONAL DAMAGE

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113. (C) With respect to Russia's actions during the crisis, Miller rejected the notion that Gazprom had suffered reputational damage. He said the question of reputational damage, along with the entire crisis, had been "politicized." Gazprom's reputation in Europe was subjective, based on whether a country is a Gazprom customer or not. Gazprom's main customers were more favorably disposed toward the company than those who are not among its primary customers and it was among the latter where the interpretation of the crisis had been against Gazprom.

114. (C) As to potential lawsuits arising from the gas crisis, Miller said Gazprom has been in "constructive discussions" with its customers and that he did not foresee any lawsuits. He said Gazprom does not see any legal basis for any suits by its customers "the way the contracts are written." He added that if there were any lawsuits, they would be by Gazprom against Ukraine.

115. (C) Miller finished his diatribe by using the crisis with Ukraine to justify Gazprom's focus on diversifying export routes to Europe (while adding that Gazprom's proposed pipelines are "not in competition" with other projects -- presumably referring to Nabucco). Noting that 80% of Gazprom's exports to Europe go through Ukraine, Miller expressed concern that Russia is overly dependent on a country "in bad shape." He said Russia worried that Ukraine is on the brink of social collapse -- "There are bandits roaming the streets; not thieves, but simply young jobless people who need money to live."

COMMENT

116. (C) Miller is likely correct that gas transit to Europe through Ukraine will continue to be a problem in the future. However, Gazprom's solution to that problem -- duplicative multi-billion dollar alternative pipelines) is not the answer. A better solution is a transparent, commercially-based gas industries in both Russia and Ukraine -- neither of which exist today.
Beyrle